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Prince-Covey & Company, Inc., A Utah Corporation v. Jerry v. Strand : Brief of Respondent Prince-Covey & Company

Utah Supreme Court

Original Brief submitted to the Utah Supreme Court; funding for digitization provided by the Institute of Museum and Library Services through the Library Services and Technology Act, administered by the Utah State Library, and sponsored by the S.J. Quinney Law Library; machine-generated OCR, may contain errors.K.S. Prince, Jr.; Attorney for RespondentKenneth Rigtrup; Attorney for Appellant

IN THE SUPREME COURT OF THE STATE OF UTAH

PRINCE-COVEY & COMPANY, INC., a Utah corporation,
Plaintiff-Respondent,

vs.

JERRY V. STRAND,
Defendant-Appellant.

Case No. [illegible]

BRIEF OF RESPOND[illegible]
Prince-Covey & Com[illegible]

APPEAL FROM JU[illegible]
of the
DISTRICT COURT OF THE [illegible]
DISTRICT IN AND FOR SA[illegible]
STATE OF UTA[illegible]
Honorable D. Frank Wilk[illegible]

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IN THE SUPREME COURT OF THE STATE OF UTAH

PRINCE-COVEY & COMPANY, INC., a Utah corporation, *Plaintiff-Respondent,* vs. JERRY V. STRAND, *Defendant-Appellant.*	Case No. 12964

BRIEF OF RESPONDENT
Prince-Covey & Company, Inc.

NATURE OF THE CASE

Respondent, the plaintiff below, brought a contract action for damages sustained by it when Appellant failed to pay for securities ordered by him and purchased for his account by Respondent.

DISPOSITION IN THE LOWER COURT

A nonjury trial was held in the District Court of the Third Judicial District, in and for Salt Lake County, the Honorable D. Frank Wilkins presiding. The Trial Court granted to Plaintiff-Respondent Judgment in the amount of $34,696.16. The Trial Court determined that Respondent had suffered damages in the amount of $37,435.84 based upon the difference between the amount which Respondent had paid for securities acquired at Appellant's request and for his account, and the amount Respondent realized from the sale of these securities (without deduction of commissions) when Appellant failed to pay for them. From this total damage figure, the Trial Court deducted the sum of $6,430 representing damages suffered by Appellant when Respondent, without Appellant's consent, sold fully paid-for securities from Appellant's account. The damage of $6,430 represented the difference between the fair market value of the converted securities, as found by the Trial Court, within a reasonable period of time after the date of conversion, and the actual amount realized by Respondent from the sale of such stock and credited to Appellant's account. To the resulting total judgment in the sum of $31,005.84, the Trial Court added costs and interest at the rate of 6% per annum from May 14, 1970, in the amount of $3,690.32.

RELIEF SOUGHT ON APPEAL

Respondent seeks an order of this Court reversing the award of damages to Appellant or, in the alternative, modifying the amount of damages awarded to Appellant by virtue of the conversion of Appellant's fully paid securities. In all other respects, Respondent requests that this Court affirm the judgment of the Trial Court.

STATEMENT OF FACTS

Respondent, a Utah corporation, is a licensed broker-dealer which buys and sells securities through interstate commerce (Record, pp. 135-36). Sometimes in late 1969, Appellant opened a special cash account with Respondent (Record, p. 136). Appellant placed orders with Respondent for the purchase and sales of various securities and Respondent executed such orders until May 18, 1970 (Exhibits 1-P and 2-D, and Record, pp. 136, 201 and 239.)

Appellant's account was intially handled in such a way as to require payment, pursuant to Federal Regulations, within seven business days of the date of purchase (Record, p. 139). In April of 1970, Appellant indicated to Respondent's agent, Keith Sudbury, that he would like to have future purchase transactions effected with the understanding that payment would be made on delivery of the stock certificates (Record, pp. 140 and 141). Pursuant to this request, Respondent so treated purchase transactions after April 10, 1970 (Recorded, p. 144).

Between the dates of April 10, 1970 and May 18, 1970, the Appellant gave to Respondent various orders for the purchase of securities for Appellant's account with the understanding that payment would be made on delivery of the stock certificates (Record, p. 144). Within 24 hours after each such transaction Respondent sent to Appellant at an address furnished by Appellant a written confirmation of the transaction by U. S. Mail, postage prepaid, and as the securities purchased arrived Respondent specifically identified them as belonging to Appellant by placing said securities in a special folder (Record, p. 223). At no time did Appellant send to

Respondent a written objection to the contents of any of the aforesaid confirmations (Record, pp. 222 and 233).

At all times prior to May 15, 1970, Appellant promptly paid for securities as the same were received by Respondent and delivered (Record, pp. 142 and 144). On or about May 15, 1970, securities purchased by Respondent for Appellant's account pursuant to Appellant's instructions were received by Respondent, and Appellant, having been notified of this fact, delivered to Respondent a check in the amount of $16,095 (Record, pp. 145, 199 and 234). On or about May 19, 1970, Respondent was notified by its bank that Appellant's check had failed to clear his bank because of insufficient funds (Record, p. 199).

On May 19, 1970, Respondent began liquidation of the transactions by selling the securities for which Appellant had not paid when delivery was tendered (Record, p. 145). Thereafter, as promptly as possible, Respondent liquidated each transaction in Appellant's account by selling the securities in an attempt to reduce the unpaid balance of this account (Record, pp. 145 and 147). As of May 18, 1970, the debit balance in Appellant's account was $100,702.84 (Record, pp. 201 and 202). From May 18 to June 18, 1970, Respondent realized the sum of $63,267.00 without deduction of commissions, through liquidation of the Appellant's account leaving a balance of $37,435.84 (Record, p. 203.)[1]

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[1]Mr. David Nelson testified that the account was reduced to $40,542.58 but the Trial Court reduced this figure by $3,106.74 representing commissions earned by Respondent upon the sales involved.

Included in Appellant's account were certain securities for which Appellant had paid but which were still being held by Respondent (Record, p. 233). Despite testimony by Respondent's agent to the effect that these securities were held as security for the faithful performance by Appellant of the credit arrangements (Record, p. 183), the Trial Court found that these securities were converted when the same were sold by Respondent. The amounts realized therefrom were credited to Appllant's account (Record, p. 78). Appellant testified that the fair market value of said stocks within two weeks from the commencement of the liquidation was $16,980 (Record, p. 235). Offsetting this claim, Respondent, pursuant to Appellant's instructions, sold $5,240 worth of these securities and paid Appellant this amount, less commissions of $152.50, in cash on May 18, 1970. (Record, p. 242), In addition, as the remaining portion of these stocks were liquidated, Respondent credited Appellant's account with amounts realized totalling $6,221 (Record, p. 129 and Exhibit 7-P).

ARGUMENT

POINT I

RESPONDENT PROVED BY A PREPONDERANCE OF THE EVIDENCE THE EXISTENCE OF AN AGREEMENT BETWEEN IT AND APPELLANT, AND THE BREACH THEREOF.

There can be no question that Appellant had an account for the purchase and sale of securities at Respondent's brokerage house. Appellant admits this fact on page 35 of his brief. The crux of Appellant's argument in Point I of his brief appears to be that a comprehensive understanding as to how the account would be handled if the customer fails to pay is an indispensable part of any contract for the sale or purchase of securities and the absence of such an understanding renders the contract incomplete and void. In addition, Appellant appears to be arguing that regardless of the merit of the foregoing proposition, Respondent had no authority to handle the account in the manner in which it was handled. The record contains persuasive evidence supporting the Trial Court's conclusions on both of these points.

The absurdity of the first proposition is obvious. The entire contract involved in the instant case was that Respondent would purchase securities in accordance with Appellant's orders and Appellant would pay for them. Appellant admitted in paragraph 2 of the Second Defense of his Answer, and has never taken a position to the contrary, that he ordered securities and that he failed to pay for them when payment became due (Record, p. 54).

The case of *Gregory-Massari, Inc. v. Purkitt*, 82 Cal Rptr. 210, 1 Cal App. 3rd 968 (1969), involved a similar failure on the part of the customer to pay for securities he had ordered. The defendant there argued that the contract involved an understanding as to how the account would be handled in the event of a failure to pay. The California Court of Appeals, in holding for the broker, said:

> "In our case the entire contract was that plaintiff would sell stock to defendants and defendants would pay for it. Performance of the agreement required no other action by either party. Liquidation of the debt in the event of defendant's default was no part of the agreement. Plaintiff did not agree to sell the stock after seven days, or at all. Its duty in that respect was imposed by the regulation. . . ." *Supra,* p. 216.

The answer to Appellant's second proposition is equally clear although it will involve more explanation. Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.,* prohibits securities brokers and dealers *from extending credit* to any customer in contravention of rules and regulations prescribed by the Board of Governors of the Federal Reserve System.[2] Regulation T, 12 C.F.R., § 220.1, *et seq.,* was promulgated by the Federal Reserve System's Board of Governors pursuant to § 7 and provides, in pertinent part of § 4 thereof, as follows:

> "(c) Special cash account.—(1) In a special cash account, a creditor may effect for or with any customer *bona fide* cash transactions in securities in which the creditor may:
>
> > (i) Purchase any security for, or sell any security to, any customer, provided, funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in *good faith* that the customer will *promptly* make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment.

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[2] 15 U.S.C. § 78g, as amended July 29, 1968, P L. 90-437, 82 Stat. 452.

> (2) In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in subparagraphs (3)-(7) of this paragraph, *promptly cancel or otherwise liquidate* the transaction or the unsettled portion thereof.
>
> (5) If the creditor, acting in *good faith* in accordance with subparagraph (1) of this paragraph, purchases a security for a customer, or sells a security to a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment to be made promptly by the customer is to be made against such delivery, the creditor may *at his option* treat the transaction as one to which the period applicable under subparagraph (2) of this paragraph is not the 7 days therein specified but 35 days after the date of such purchase or sale.
>
> (7) The 7-day periods specified in this paragraph refer to 7 full business days. The 35-day period . . . refers to calender days, but if the last day of any such period is a Saturday, Sunday, or holiday, such period shall be considered to end on the next full business day. For the purposes of this paragraph, a creditor may, at his option, disregard any sum due by the customer not exceeding $100." (Emphasis added)

Section 3 of the Regulation, 12 C.F.R. § 220.3(a), requires all financial relations between a broker and its customer to be handled in a "general account" with the exception of those transactions specifically authorized to be handled in one or more "special accounts" provided for in § 4. Special account transactions must be conducted in strict compliance with the terms and conditions set forth in § 4 or a violation of Regulation T occurs. It is conceded by Appellant that all transactions between Respondent and Appellant were handled in a special cash account. Brief for Appellant, Statement of Facts, p. 5; Record, p. 136. Section 4(a)(2) states that, "Each . . . special account shall be recorded separately and shall be confined to the transactions and relations specifically authorized for such account. . . ." Appellant's account at Respondent's brokerage house was received into evidence as Exhibit 1-P. Record, p. 172.

The "cash account" (technically termed the "special cash account") described in the Regulation is one in which the customer is extended credit where transactions are effected with the understanding that they will be settled *promptly.* 220.4(c)(1)(i), *supra,* p. 7. The meaning of the word "promptly" is that these transactions will be settled within the two or three days required by use of the usual transmittal facilities. See Memorandum of the Board of Governors, 12 C.F.R. Reg. 220.4(c). In any event, full cash payment must be made within 7 days after the date of purchase.

There is an exception in the special cash account provisions of Regulation T pursuant to which, if a purchase is made by a customer with the understanding that payment is to be made on delivery, the broker/dealer may, *at his option and acting in good faith,* treat the transaction as one in which the applicable period of time for payment is not 7 full business days but 35 calendar days. § 220.4(c)(5) and (7), *supra,* p. 7. In such a purchase transaction, the broker/dealer has the obligation to deliver and obtain payment as soon as possible but since a purchased security might not be delivered to the broker within a 7-day period, the period within which delivery must be made to the customer and payment must be made to the broker is extended to not more than 35 days. Upon request of Appellant, and in light of his excellent record of payment for securities purchased (Record, p. 142) and because of the size of his account (Record, pp. 138 and 139), he was informed on or about April 10, 1970 that future transactions in his account could be paid for upon delivery to him by Respondent of the securities purchased, or on a C.O.D. basis (Record, p. 156). For the period from then until May 15, 1970, Appellant complied with the C.O.D. arrangement (Record, p. 144), and paid promptly upon delivery of the purchased securities. (Record, pp. 143 and 144).

It should be noted that the 7-day maximum payment period under Regulation T is applicable to all transactions except those where the *broker* elects to treat the transacton as one to which the applicable period is 35 days and that the broker can only extend credit (whether for up to 7 or up to 35 days) if the broker in good faith believes that the customer will promptly make full cash payment upon delivery. § 220.4(c)(5), *supra,* p. 7. This "good faith" requirement is for the purpose of prohibiting an extension of credit in any transaction where the broker-dealer knows the customer may not be able to pay. In short, the broker is prohibited from effecting any further purchases for a customer who the broker, in good faith, does not believe can pay, and additionally the broker is prohibited from continuing to extend credit with regard to previous purchases for which payment has not been made. The broker must receive payment immediately or he must promptly cancel or otherwise liquidate the transaction or transactions.

In *Matter of Naftalin & Company, Inc.*, CCH Fed. Sec. L. Rep. 92,995 (8th Cir., Nov. 29, 1972, certain broker/dealer creditors of a bankrupt broker/dealer (Naftalin) appealed from a district court decision holding that these creditors had violated Regulation T and directing the bankruptcy Referee to determine what these creditors' claims would have amounted to if the transactions with Naftalin had been liquidated in compliance with the Regulation. Naftalin had special cash accounts with some 27 broker/dealers and for some period of time had been selling stocks to these dealers for his own account. Although the Regulation prohibits sales for a customer in a special cash account where the customer does not own the security at the time the order is placed, Naftalin's usual practice was to place orders for the sale of securities which he did not own but looked to purchase at a lower price in the future. Over a period of time preceding the transaction in question, Naftalin had been very slow in making deliveries but he had always given plausible excuses for the delays and had always represented to the other dealers that he did, in fact, own the securities and that the reasons for delay had to do with transfer agents, other brokers failing to deliver Naftalin's securities to him, or other reasons of this nature.

In August of 1969 Naftalin placed orders for sales of securities in excess of $10,000,000 and when the prices of the securities went up by over $1,000,000 he finally confessed that he did not own the securities and could not make delivery. During the weeks between the sales and the confession, brokers inquired as to when they could expect delivery, and Naftalin met these inquiries with typically evasive and misleading replies. After the confession, the brokers bought-in the undelivered stocks at an aggregate cost in excess of $1,285,000. The total loss claimed was the difference between this purchase price and the original price of the undelivered securities, or $653,000.

Naftalin claimed that the failure of these creditors to comply with section 7 of the Securities Exchange Act made the short-selling scheme possible and that they should therefore be prohibited from enforcing their contracts. The first violation alleged by Naftalin was that the brokers could not "in good faith" have believed that the securities sold would be "promptly" delivered in light of Naftalin's past performance. The district court decision, rejecting this contention on the grounds that the brokers could well have believed that Naftalin owned the securities despite his slow deliveries, was affirmed. Naftalin's second argument was that the brokers should have promptly liquidated the transactions by repurchasing the sold securities when Naftalin did not deliver in 7 days. While the court did not entirely agree with

Naftalin's position,[3] it did hold that each transaction involved should have been liquidated at such time as the broker involved *no longer had a good faith assurance* that the securities sold would be promptly delivered. The court stated that, "We think the broker/dealer is under a *continuing obligation* to maintain a good faith assurance that the sale transaction is, in fact, a bona fide cash transaction and that the securities sold will be promptly delivered." *id.* at 93,001. (Emphasis added).

The transactions in the instant case must be divided into two categories: namely, the transactions for which delivery to Appellant was made on May 15, and for which Appellant was unable to pay and secondly, those purchase transactions made prior to May 19, the date upon which Respondent was notified of the bad check, and relative to which the securities purchased had not yet been received. Respondent was compelled to promptly liquidate all securities in the first category because prompt liquidation is required by the clear and unmistakable language of Reg. § 220.4(c)(5).

With respect to the securities in the second category, the plain meaning of subsection (5) and the holding of the *Naftalin* case, *supra*, p. 11, is that the broker may only extend credit until the time of delivery in those cases where the broker in good faith believes that the customer will promptly make full cash payment upon such delivery. Thus, after May 19, 1970, Respondent could no longer extend credit on the securities in the second cate-

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[3]Section 220.4(c)(2) of the Regulation contains a specific liquidation requirement for purchase transactions in special cash accounts but there is no equivalent liquidation provision for sales transactions.

gory because Respondent was now aware of Appellant's obvious inability to pay.

In *Naftalin,* the same rules had to be applied. The difference, of course, was that in *Naftalin* the customer had not promptly delivered securities while in the instant case the customer failed to promptly deliver payment for securities. The rule in both cases is that at the time the broker can no longer believe, in good faith, that the customer is going to perform promptly, the broker must liquidate the transaction. In *Naftalin* the court stated:

> "The good faith of a broker/dealer who has originally executed a sell order in compliance with Regulaton T must gradually dissipate as time passes without delivery of the securities ... If no credible explanation for the delay is forthcoming, the transaction must be bought-in immediately." *Id.* at 93,002.

The difficult task in the *Naftalin* case was to determine the point in time when the creditors were required to take affirmative action. There is no difficulty in determining this time in the instant case because the minute Appellant's check bounced, Respondent knew Appellant could not pay for the purchases involved or for any other purchases he had theretofore made.

Appellant argues that Respondent's capital position may have been "precarious" and that Respondent elected to "save its own hide by sacrificing the defendant." Brief for Appellant, pp. 17 and 18. It is irrelevant whether or not the Respondent's capital position was precarious in that a failure to liquidate the account would have violated Regulation T and would have subjected Respondent to disciplinary proceedings. In the *Matter of John W. Yeaman, Inc. and John W. Yeaman,* SEC Securities Exchange Act Release No. 34-7527 (Feb. 10, 1965), the SEC held that the failure of a broker to liquidate customer's purchases on a special cash account when full payments were not made within 7 days after the execution of the transactions violated Regulation T. The Commission stated that it was no excuse for the violation that the purchasers were good credit risks. See also *Maryland Securities Co. Inc. and Morton Sandler,* 40 SEC 443 (1960).

For the same reason, there was no requirement that Respondent give notice to Appellant or that any "reasonable, good faith effort" be made by Respondent to effect recovery on the check. Similarly, there was no requirement that Respondent obtain Appellant's consent to the liquidation of the various transactions. Appellant's reliance upon these arguments indicates a lack of understanding of the mandatory nature of Regulation T in requiring prompt liquidation of the transaction.

Appellant contends that there was no testimony or evidence that any stock had been delivered to him. The Trial Court found in Finding of Fact No. 10 that "on May 14, 1970, securities purchased by plaintiff for defendant's account pursuant to defendant's instructions were received by plaintiff, and defendant, having been notified of this fact, delivered to plaintiff a check in the amount of $16,095" (Record, p. 77). The securities received on that date were "delivered" within the meaning of the Uniform Commercial Code, § 70A-8-313, Utah Code Annotated, 1953, as amended, when Respondent, upon purchase, sent to Appellant confirmation of the purchase and when, on May 14, 1970, Respondent identified a specific security in Respondent's possession as belonging to Appellant (Record, p. 223). As to securities received after the above date, plaintiff's Exhibit P-1 indicates the days upon which deliveries of all stock certificates were made by virtue of the receipt of the same by Respondent and the placing of the same in the special folder maintained for all of Appellant's purchases and sales.

Appellant attempts to attach some significance to the fact that Respondent did not introduce into evidence each individual confirmation regarding each purchase and sale in Appellant's account. However, as Appellant admits (Brief for Appellant, pp. 20 and 21), it is apparent that Respondent could have provided confirmations on every transaction since Respondent files its confirmations numerically by transaction number and Respondent's computer run (Exhibit P-1) lists each transaction by the transaction number. In addition, the computer run contains *all* the information contained on the confirmation slips. Compare Exhibit P-1 with Exhibit P-5.

Appellant contends that the reason it was necessary for Respondent to provide all of the confirmations is that § 4(a)(2), *supra*, p. 4, requires that each special account must be recorded separately. An examination of plaintiff's Exhibit P-1 indicates that each transaction was recorded separately. However, even if this were not the case it is difficult to understand the thrust of Appellant's argument. If that argument is that Respondent violated Regulation T, the answer is that such a violation would not bar Respondent's recovery in this matter. In *E. F. Hutton & Co. v. Weinberg,* 151 NYLJ No. 40, p. 16, (1964), the New York Supreme Court affirmed the granting of a summary judgment in favor of a stockbroker in its action against a customer on a note signed by the customer to cover deficiencies in the customer's account. The customer alleged that the note was unenforceable since the underlying transactions were in violation of the Regulation T requirements. The court ruled that the facts, if true, of the broker's violation of the Regulation T requirements were not sufficient to bar the broker's recovery from the customer.

In addition, the violation alleged by Appellant results from Appellant's misconception as to the meaning of a "special account." The Regulation provides for a number of special accounts included among which are a special cash account, a special omnibus account, a special arbitrage account, and a special commodity account. The meaning of the provision cited by Appellant is that a broker may not record transactions relative to a special arbitrage account in the same records as the broker records transactions relative to the special omnibus account. However, all transactions falling within one account are to be recorded in the same place. The fact is that all transactions handled by Respondent for Appellant were transactions in the special cash account and therefore were required to be recorded in the same place. There is no provision in the special cash account regulations requiring recordation of a C.O.D. transaction (§ 220.4(c)(5), *supra*, p. 8), to be made in a different set of books from the recordation of a 7-day transaction (§ 220.4(c)(2), *supra*, p. 8)

There is a similar lack of relevance in Appellant's argument that part of Appellant's large debit balance was due to 2,000 shares of Agau which were improperly included in Appellant's account. The transactions involving the Appellant's bad check were not liquidated because of a large debit balance. They were liquidated because of a failure to promptly pay for securities purchased, upon delivery, pursuant to the terms of the special cash account rules regarding these transactions. Appellant's account was debited each time he purchased securities but, until May 19, 1970, Appellant was not obligated to pay for any such purchases until Respondent had received the stock certificates from the seller. (Brief for Appellant, p. 208). From the foregoing discussion it should be clear that Respondent not only had the authority to handle Appellant's account in the manner it was handled, it had the affirmative obligation to so handle it.

POINT II

THE LIQUIDATION OF ALL APPELLANT'S PURCHASE TRANSACTIONS PURSUANT TO THE RULES OF REGULATION T DID NOT RESULT IN A CONVERSION OF APPELLANT'S PROPERTY.

Appellant advances a novel theory in Point II of his brief. The initial argument contained therein is that

Appellant had no obligation to pay for securities purchased until there was an actual delivery of stock certificates. Appellant thereby confuses the extension of credit with a contract obligation to pay for securities purchased. The contract between Appellant and Respondent was that Respondent would purchase securities in accordance with Appellant's orders and that Appellant would pay for them. *Supra,* p. 6. Appellant admitted in the third defense of his Answer that he ordered securities from Respondent and that he failed to pay for them when payment became due.

From the foregoing invalid proposition and based upon the Trial Court's findings of liability, Appellant concludes that there must have been an actual or constructive delivery of the stock to the Appellant and that it follows that Appellant was the legal owner thereof. Apparently the argument is that Appellant became the legal owner of the purchased securities at the time the confirmations were sent, notwithstanding the fact that Appellant never paid for these securities. Finally, Appellant argues that these securities "owned" by him, but never paid for by him, were "converted" by the Respondent and that this conversion resulted in damages to Appellant.

Appellant's theory that securities for which he failed to pay were "converted" by Respondent upon liquidation of the transactions involved is not supported by a single case or statute. To the contrary, there are a great number of cases where a broker who has liquidated an account has sued for and recovered from his customer damages based on the difference between the value the customer agreed to pay for the securities and the amount realized upon liquidation. In effect, Regulation T, in order to control the extension of credit by broker/dealers in the securities market, creates a security interest in the securities purchased for a customer's account and compels the broker/dealer to foreclose upon this interest by cancelling or liquidating the transaction if payment is not promptly made or if the broker/dealer, acting in good faith, can no longer extend credit.

In *Gregory-Massari, Inc. v. Purkitt, supra*, p. 6, a registered broker/dealer sued for damages for breach of contract. The dealer accepted an order from the defendants and sent them a confirmation of the sale. The confirmation contained a payment date in compliance with Regulation T. Failing to receive payments, the broker sold the securities several months later[4] at a loss and brought an action to recover damages based on the difference between the amount realized on sale and the original purchase price. The court stated that the contract was entered into so that the broker/dealer would purchase securities for the defendants and the defendants would pay for them. Based upon this contract, the court held that the plaintiff had stated a cause of action for damages. *Accord, Nichols & Co. v. Columbus Credit Corp.*, 126 N.Y.S. 2d 715 (Sup. Ct. 1953) and *Irving Weis & Co. v. Offenberger*, 220 N.Y.S. 2d 1001 (Mun. Ct. 1961).

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[4]In Gregory-Massari the customer raised a defense based upon the broker's failure to "promptly" liquidate the transactions involved. The court allowed an offset based upon the higher price the broker could have obtained had he promptly liquidated. No defense of this nature has been raised by Appellant in the instant case and, in fact, the main thrust of Appellant's arguments seems to be that Respondent was too prompt in its liquidations.

If Appellant were to prevail on his theory, a broker/dealer liquidating one or more transactions as required by Regulation T would always be guilty of a conversion. Regulation T would necessarily be invalid for constitutional reasons, and the entire purpose of the Regulation, which is to prohibit excessive credit in the stock market, would be thwarted.

Even if the Court were to find that these securities were converted, these damages claimed by Appellant were never proven and must be computed on the basis of values set forth in paragraph 4 of Appellant's counterclaim.[5] The per share values set forth on page 27 of Appellant's brief were never offered into evidence. Further, it appears from the testimony that Appellant arrived at his figures on value by asking various brokers for the value figures. Respondent believes that its hearsay objections, overruled by the Trial Court, to this testimony on value was well taken. *Infra,* pp. 22-25.

POINT III

THE TRIAL COURT'S FINDING OF $6,430 DAMAGE TO APPELLANT ON HIS COUNTERCLAIM IS EXCESSIVE.

In his counterclaim, Appellant alleged that certain shares of stock for which he had paid in full were in the possession of Respondent as of the time Appellant's account was liquidated. Appellant further alleges and claims that said fully paid shares of stock were sold by

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[5]Appellant testified that the total value of 5 different securities for which he had fully paid but which were being held by Respondent was $16, 980. Record, p. 235. He did not, however, testify as to values of individual securities.

Respondent without Appellant's consent and without authority and that such sales constituted a conversion by the Respondent of Appellant's stock resulting in damages to Appellant in the amount of $16,605 (Record, p. 65). By his testimony, Appellant revised this figure to $16,980 (Record, p. 235). On page 30 of his brief, Appellant attempts to revise the figure again to the sum of $17,980 by virtue of adding the "individual figures pertaining to the stocks in question." However, Appellant never introduced individual value figures pertaining to the stocks into evidence and certainly cannot be allowed to introduce them on appeal. This Appellant attempts to do on page 27 of his brief by copying values per share of selected stocks from paragraph 4 of the First Cause of Action in his counterclaim. Because of the lack of individual stock prices, the only testimony in evidence is that the fair market value of the fully paid stock converted by Appellant was $16,980 (Record, p. 235).

Although Appellant testified that the total value of the securities owned by him and sold by Respondent was $16,980, this evidence should have been excluded by the Trial Court by reason of the fact that it was improperly admitted over Appellant's hearsay objection. In the cross examination of Appellant, the following questions by Respondent's counsel and answers by Appellant took place:

> (Q) Now, Mr. Strand, you claim a total value of some $16,000 is that correct?
>
> (A) That is correct.

(Q) And that total value is determined how?

(A) By the representative prices that these stocks traded at within about a two-week period.

. . . .

(Q) Where did you get the sales prices?

(A) From representative brokers on actual transactions, on actual trades.

Mr. Prince: I object , then, to the whole testimony with regard to the price because I object to it as hearsay

Mr Faber: Your Honor, he can't object at this time. He has been querying the witness for 20 minutes now. Now, he wants to object to it.

Mr. Prince: That's the first time I found out where he got them.

The court: Overruled.

(Record, pp. 243 and 244)

An examination of the record will indicate that it was not true that Respondent's counsel had been "querying the witness for 20 minutes" prior to the hearsay objection. To the contrary, the above testimony was the first time Mr. Strand had disclosed the manner in which he determined stock prices. It is the general rule that hearsay evidence is incompetent and inadmissible to establish a fact. *29 Am. Jur. 2nd* 551 (Evid. § 493). Hearsay is defined as testimony in court of a statement made out of court, such statement being offered as an assertion to show the truth of matters asserted therein, and thus resting for its value upon the credibility of the out-of-court asserter. McCormick, *Handbook of the Law of Evidence, Hornbook Series,* page 460 (1954). Thus, hearsay is evidence which derives its value not solely from the credit to be given to the witness on the stand but in part from the veracity and competency of some other person. *29 Am. Jur. 2nd* 551 (Evid. § 493).

While the hearsay rule is subject to a large number of exceptions, the two underlying reasons for any exception to the rule are the necessity for the exception and the circumstantial guarantees of the trustworthiness of the offered evidence. *Matthews v. United States,* 217 F.2d 409, 417 (5th Cir., 1954). Neither of the tests were met in this case. If Appellant had wished to establish stock prices during the period of time following his bounced check, he could have easily introduced expert testimony to accomplish this. Thus, there is no necessity for the application of an exception to the rule. In addtiion, the fact that Appellant did not testify as to any specific trades, by offering confirmations of actual sales or an expert, casts grave doubts upon the trustworthisness of the offered evidence. Finally, it was obviously in Respondent's best interests to realize as much as possible from sales of the converted securities. The fact that Respondent could only realize the amounts set forth on Exhibit 7-P is the best evidence of the actual fair market value of the securities as of that time.

Later, during *voir dire* examination by his counsel, Appellant testified that sales from which he determined the price of stock were sales from his account at respondent's brokerage house (Record, p. 250). Subsequently, Appellant testified that these were sales from his account at Parker-Mawood (Record, p. 251). Even assuming this were true, however, wherever the sales figures may have come from they are still subject to the same hearsay objection because they were apparently relayed to Appellant from "representative brokers" who were not called as witnesses in this case.

Assuming this court affirms the Trial Court's ruling on the hearsay objection, Appellant still has overstated the damages he sustained. In paragraph 7 of the First Cause of Action of Appellant's Counterclaim, Appellant concedes that the foregoing figure should be reduced by the sum of $5,087.50 by reason of sales of stock and corresponding cash disbursements made by Respondent to Appellant (Record, p. 65). Respondent has no quarrel with this position. These cash disbursements were made before Respondent knew that Appellant's check had bounced and were, therefore, normal transactions in the account. Commissions totaling $152.50 were properly charged on these transactions. By consulting Exhibit 1-P it can be seen that the $5,087 paid to Appellant represented sales of the following shares of stock on the following date:

		Gross	Commission	Net
5-18-70	2,000 Investestate	$ 240.00	$ 15.00	$ 225.00
5-18-70	5,000 Investestate	600.00	37.50	562.50
5-18-70	300 Agau Mines	1,650.00	37.50	1,612.50
5-18-70	500 Agau Mines	2,750.00	62.50	2,687.50
		$5,240.00	$152.50	$5,087.50

Since the $5,087,50 was disbursed to Appellant against the sales of the above stocks (Record, p. 65) the above shares of stock must be subtracted from the number of shares actually converted by Respondent. It, therefore, appears that the following securities were found to be converted by the Trial Court:

Classic Mining	27,500 shares
Investestate	23,000 shares
Stansbury	4,000 shares
King Oil	2,000 shares

By subtracting the $5,240, representing cash delivered to Appellant plus commissions charged on the sales, from the total value claimed by the Appellant, the evidence will support a finding that Respondent converted $11,740 worth of stock. By consulting Exhibit 7-P, it can be determined that Appellant, upon the sale of this stock, gave Respondent credit in his account at the following values:

Classic	27,500 shares at	13⅛ cents per share =	$3,652
Investestate	23,000 shares at	6.3 cents per share =	1,449
Stansubury	4,000 shares at	7½ cents per share =	1,449
King Oil	2,000 shares at	41 cents per share =	820
			$6,221

Counsel for Appellant stipulated that the foregoing prices were the prices Respondent received upon the sales of the various securities (Record, p. 129). Appellant testified that in his total damage figure he had not subtracted the credit given to his account by virtue of the sale of these stocks (Record, p. 259).

The Trial Court, in paragraph 7 of its Conclusions of Law (Record, p. 79) found that Respondent did not have the right to sell these fully paid securities and, therefore, held that the Appellant was entitled to damages for their conversion (Record, p. 79). The proper computation of these damages would be to subtract from the $11,740 (representing the value of the converted securities) the $6,221 credit given to Appellant on his account. The maximum damage figure which can, therefore, be awarded to Appellant on his counterclaim is $5,519.

The incorrect figure of $6,430 awarded to Appellant by the Trial Judge arose by virtue of the fact that Appellant's attorney stated that the total amount Appellant was seeking was the sum of $11,517.50 (Record 265). From this amount claimed by Appellant's counsel, the trial judge subtracted the offset of $5,087.50 conceded by Appellant in paragraph 7 of the First Cause of Action of his counterclaim (Record, p. 65). While this figure is supportable on the record because of the inaccurate claim made by Appellant's counsel ,it does not represent the actual damages for the conversion, and this court should, therefore, reverse and hold that Appellant is entitled to no damages on his counterclaim by reason of the improper admission of hearsay evidence. Alternatively, this court should hold that the damage figure should be revised to $5,519, the only figure supportable by the evidence.

POINT IV

THE STATUTE OF FRAUDS SHOULD NOT BE INVOKED TO PRECLUDE RECOVERY IN THIS CASE.

Appellant's argument that the contracts for the purchase of securities involved in this case are unenforceable by reason of the statute of frauds can be disposed of by a close examination of Uniform Commercial Code § 70A-8-319, Utah Code Annotated 1953, as amended. This section contains the statute of frauds rules relative to the sale of securities. Although Respondent need fit only one of the four exceptions therein contained in order to avoid application of the statute, it is interesting to note that Respondent can satisfy each of the exception provisions.

The first exception is where there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price. Respondent acted as the authorized broker for Appellant. Findings of Fact numbers 4, 5 and 6 (Record, pp. 76, 77). Respondent introduced as Exhibit 4-P its form confirmation slip and introduced testimony to the effect that such a confirmation slip was mailed to the selling broker by U.S. Mail, postage prepaid, within 24 hours after each purchase shown on Exhibit 1-P. Exhibit 4-P indicates that a contract has been made and states the quantity of securities, describes the same and states the price. There is no question but what the writing was signed by the broker in that § 70A-1-201 defines the word "signed" as including any symbol executed or adopted by a party with present intention to authenticate a writing.

Similarly, subsection (b) is satisfied in the instant case by reason of the fact that delivery of the securities was, in each case, accepted by Appellant. Under subsection(1)(a) of § 70A-8-313, delivery to a purchaser occurs when he *or a person designated by him* acquires possession of a security or under subsection (c) when his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser. Acceptance must be presumed by virtue of the fact that Appellant did not object, in writing, to any confirmations (Record, pp. 222 and 223) as required by § 70A-8-319(c).

.... If the foregoing were not sufficient ,an analysis of subparagraphs (c) and (d) should leave no doubt as to the inapplicability of the statute of frauds. In Findings of Fact numbers 6, 7 and 8, (Record, p. 77) the Trial Court found that between the dates of April 10, 1970 and May 18, 1970 the Appellant gave to Respondent various orders for the purchase and sale of securities for Appellant's account and that Respondent executed said orders in accordance with Appellant's instructions. The Court found that within 24 hours after each such transaction Respondent sent to Appellant a written confirmation of the sale or purchase and as the securities purchased arrived Respondent specifically identified them as belonging to Appellant by placing the securities in a special folder. Finally, the Trial Court found that at no time did Appellant send to Respondent a written objection to the contents of any of the aforesaid confirmations. The conclusions reached by the Trial Court are amply supported by the testimony of David E. Nelson, an officer and member of the Board of Directors of Respondent and a principal of Respondent. Record 221-223.[6] Thus subparagraph (c) of § 70A-8-319 is satisfied.

The final exception to the statute of frauds rule is contained in subparagraph (d) and occurs where the party against whom enforcement is sought admits in his pleadings, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price. In paragraph of the First Cause of Action of Appellant's Counterclaim, (Record, p. 64) Appellant states that:

> "From the fall of 1969 through June 1970, the defendant had a special cash account with the plaintiff corporation, Account No. 01-182048-009."

Upon the introduction of Exhibit 1-P, Appellant's counsel, when asked the nature of the exhibit stated:

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[6]Appellant appears to be claiming that by introducing each of the confirmations for the individual transactions Respondent would have been able to prove their receipt by Appellant. However, even had these confirmations been produced, Respondent could not have thereby proved receipt thereof by Appellant. That these confirmations were received by Appellant is clear from Mr. Nelson's testimony that they were mailed to him by U. S. Mail, postage prepaid, in the usual course of business (Record, p. 222) and by the fact that Appellant received all of the monthly statements, summarizing each of the transactions, which he introduced into evidence as his Exhibit D-2.

> "Its [sic] a computer run of the *defendant's account* at Prince-Covey, a partial computer run. I think maybe the beginning part of it isn't there." Record, p. 172.

Exhibit 1-P contains each transaction involved in Appellant's account, and includes the stated quantities of described securities at defined or stated prices. Further, Appellant admits in paragraph 2 of his second defense to "having a special cash account with the plaintiff. . . . The defendant admits that the plaintiff did extent him credit in Salt Lake County, State of Utah, in connection with the purchase of certain securities." Record, p. 53. Finally, the second paragraph of Appellant's third defense in Appellant's Answer states:

> "Defendant admits ordering securities from the plaintiff, admits failure to pay for the securities when payment became due. . . ." Record, p. 54.

In paragraph 3 of the same defense, Appellant includes the following admission: "Defendant admits having made orders for the purchase of securities. . . ." Record, p. 54. From the admissions contained in the pleadings and in the testimony, it must be concluded that Appellant has admitted contracts for the purchase of stated quantities of described securities at stated prices.

CONCLUSION

Appellant has laboriously reargued the facts of this case and seeks reversal on that basis. He makes little effort to argue the law as evidenced by the lack of authorities cited in his brief. The Findings of

Fact made by the Trial Court are all supportable by the evidence and so canot be said to be clearly erroneous.

Respondent respectfully submits that the judgment of the Trial Court should be affirmed in all respects except for the $6,430 damages awarded to Appellant on its counterclaim alleging conversion of certain of Appellant's securities. With respect to the Appellant's counterclaim, this Court should hold that Appellant is entitled to no damages by reason of the improper admission of hearsay evidence and, therefore, judgment should be entered for Respondent for $37,435.84 plus interest from May 14, 1970 and costs. Alternatively, this Court should hold that the damage figure of Appellant's counterclaim should be revised to $5,519.00 and, therefore, judgment should be entered for Respondent for $31,916.84 plus interest from May 14, 1970, and costs.

Respectfully submitted,

PRINCE, YEATES, WARD,
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Received two copies of this RESPONDENT'S BRIEF this .... day of January, 1973.

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